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STATEMENT OF

CHARLES A. BOWSHER

COMPTROLLER GENERAL OF THE UNITED STATES

BEFORE THE

COMMITTEE ON GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

ON

S. 1527, THE CIVIL SERVICE PENSION

REFORM ACT OF 1985

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Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss S. 1527, a bill proposing a new retirement program for federal employees covered by social security. The Social Security Amendments of 1983 required all federal civilian employees hired after December 1983, to participate in social security. The Congress has set January 1, 1986, as the target date for establishing new retirement programs for these employees. This bill applies to new employees who otherwise would have been in the civil service retirement system--the retirement plan covering most federal civilian employees. The bill also would allow employees covered by the current retirement system to transfer to the new program.

During the past 10 years, we have issued a series of reports covering a number of issues related to basic policies, financing, and benefits of the civil service and other federal retirement programs. A common thread that ran throughout many of these reports was the need for the establishment of an overall policy to guide retirement system development and improvement.

During these many years of reviewing federal retirement matters, we have become convinced that a reasonable standard on which to base federal retirement benefits is the prevailing private sector practice. Heretofore, this has been a difficult standard to apply because federal employees in the civil service retirement system were not under social security. Private sector retirement programs are constructed to supplement social

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security. Federal retirement programs could not be constructed in the same way. Now that new federal employees are covered by social security, the Congress has the unique opportunity to take advantage of the experiences of private sector employers in designing their retirement programs to supplement social security benefits. Adoption of the policy that federal retirement programs should be fairly comparable with private sector programs would assure federal employees of equitable treatment with other employees in the Nation and would also assure the taxpayers that federal retirement practices are reasonable. In this regard, we were pleased to note that one of the stated purposes of S. 1527 is to provide federal employees with retirement benefits comparable with good private sector programs.

To assist your Committee in designing a new retirement program, we gathered and analyzed considerable information on nonfederal retirement programs. The detailed results of our analysis are included in three of our reports entitled, Features of Nonfederal Retirement Programs (GAO/OCG-84-2, June 26, 1984), Benefit Levels of Nonfederal Retirement Programs (GAO/GGD-85-30, Feb. 26, 1985) and Retirement Before Age 65 is a Growing Trend in the Private Sector (GAO/HRD-85-81, July 15, 1985).

We believe S. 1527 represents a comprehensive and thorough retirement program design. It combines a three-tiered approach to retirement--social security, a defined benefit pension plan, and a thrift plan--with free basic life insurance and a separate

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long-term disability plan. We found this approach to be typical among private sector employers also. Moreover, many of the specific provisions of the pension plan portion of the proposed program are completely consistent with prevailing pension plan provisions in the private sector. Other aspects of the pension plan and the thrift plan, however, are somewhat different from what the private sector programs we examined usually provided.

The cost of the proposed retirement program is estimated to be slightly higher than the average private sector retirement program. Some private sector programs cost more. However, we believe that maintenance of comparability with respect to the total compensation package is more important than is maintenance of exact comparability with respect to each element of the package. Since this bill deals with only two (retirement and life insurance) of the many elements (pay, leave, health insurance, etc.) of total compensation and since the cost differential is small, we believe that this bill is entirely consistent with the objective of achieving comparability of the total compensation package.

We are not suggesting that, to be comparable, the federal employee retirement program should necessarily "mirror" private sector programs. In fact, we believe the retirement program proposed by S. 1527 is a reasonable one and would serve federal employees well. However, for your information as you consider the bill, I would like to briefly discuss the areas in which the bill does and does not reflect retirement program features typically found in the private sector.

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Retirement age

The bill provides for unreduced pension plan benefits to be paid at age 62. Employees with 30 years of service could retire as early as age 55, but their benefits would be reduced by 2 percent for each year they are under age 62. Employees with at least 10 but fewer than 30 years of service could also retire by age 55, but would be subject to a benefit reduction of 5 percent for each year they are under age 62.

Our analysis of private sector pension plans showed that age 62 is usually the earliest age at which employees can receive unreduced pension benefits. Also, nearly all the private sector pension plans we examined provide for early retirement with reduced benefits at age 55.

Some private sector plans, like the bill proposes, apply different reduction percentages for long- and short-service employees who retire early. More typically, however, the early retirement requirement is age 55 with 10 years of service, and benefit reductions are about 4 percent a year for all retirees younger than age 62.

When considering this aspect of S. 1527, the Committee should be aware of the fact that, while it differs from typical private sector practices in the amount of the reduction, the proposed early retirement provision would continue the advantageous treatment of long-service employees that now exists in the current civil service retirement system. In our opinion, this variance from private sector practices is defensible from a

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personnel policy standpoint because it encourages and rewards career federal service.

Benefit amounts

The pension plan proposed by S. 1527 provides a benefit of 1 percent of high 5-year average annual salary for each year of service. Pension plan benefits would simply be added to social security benefits.

Use of a 5-year salary average for benefit computation purposes is consistent with the overwhelming majority of private sector plans. However, the proposed "add on" of plan benefits to social security is not the typical private sector approach.

Because social security benefits, as a percent of salary, decrease as income levels increase, private sector pension plans usually use some form of integration to compensate for social security's "tilt" to lower income employees. Between 64 and 96 percent of private sector pension plans included in the surveys we reviewed were integrated with social security. For example, the average benefit formula in plans surveyed by the Bureau of Labor Statistics, which was the primary source of information on private sector plans we studied, provided for each year of service 1.5 percent of the high 5-year average salary, less 1.25 percent of the employee's social security benefit.

The "add on" of plan benefits to social security causes benefit levels in the proposed plan to be generally lower for average and higher income employees and higher for lower income employees than in the typical private sector plan. The proposed

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plan would provide about 27 percent of final salary to employees at all income levels at age 62 and 30 years of service. In contrast, the plans in the Bureau of Labor of Statistics survey averaged about 26 percent at the $20,000 salary level, 29 percent at the $30,000 salary level, 31 percent at the $40,000 salary level, and 32 percent at the $50,000 salary level.

Cost-of-living adjustments

The bill calls for annuities to be adjusted each year by the increase in the Consumer Price Index (CPI) less 2 percent. Our study of private sector practices showed that the average increase each year in annuities was approximately 40 percent of the change in the CPI while large employers of more than 10,000 employees granted increases averaging close to 60 percent. The appropriateness of the bill's provision in terms of private sector comparability obviously depends on future inflation rates and, consequently, cannot be accurately gauged. CPI increases above 4 percent would give the federal retiree at least 50 percent protection.

Vesting

The proposed pension plan provides for vesting--the point in time at which a participant has earned the right to a future benefit--at 5 years of service. The typical private sector plan requires 10 years of service for vesting to occur, but the trend is toward earlier vesting.

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Employee contributions

The proposed pension plan requires no employee contributions. This is consistent with the private sector approach. The studies of private sector plans we reviewed showed that very few plans require employees to contribute toward the cost of pension benefits. For example, 93 percent of the employees covered by the Bureau of Labor Statistics survey were in plans that did not require employee contributions.

Disability benefits

S. 1527 provides that long-term disability benefits will come from a separate insurance plan rather than the pension plan. Our work has shown that the insurance approach is most often used by private sector employers for salaried employees.

The proposed insurance plan would provide 60 percent of salary to employees who meet the social security program's criteria for disability benefits (inability to perform substantive gainful employment) less any social security benefits they receive. This arrangement is consistent with benefit levels in private sector insurance plans.

Employees who do not meet the social security disability criteria but are disabled for useful and efficient service in the positions they occupy would also receive insurance benefits under S. 1527. They would receive 60 percent of salary in the first year and 40 percent thereafter. We believe this aspect of the proposal is a good one. It will provide benefits to employees who cannot perform their jobs but are not totally

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disabled for other work, while reserving greater benefit amounts for those employees who cannot perform any work at all.

Survivor benefits

In general, the survivor benefit program proposed in S. 1527 closely parallels private sector practices. Social security and free life insurance coverage would comprise the basic survivor benefit program, and the survivors of vested employees would receive additional benefits from the pension plan at the time the deceased employee would have been eligible to retire. Retiring employees could also elect survivor coverage. In all cases, actuarial reductions in benefit amounts would be required to pay for the survivor coverage as is the practice in the typical private sector plan.

We did note one inequity in the proposed program. Employees who leave government employment after at least 5 years of service would retain their vested rights to survivor coverage under the bill. Benefit payments to their survivors could begin when the former employee would have reached 55. This would afford preferential treatment to some deferred annuitants over active employees. Benefits for survivors of active employees under the bill cannot begin until the employee would have been eligible to retire. A deferred annuitant or employee with fewer than 10 years of service would not be eligible to receive a pension until age 62, but the deferred annuitant's survivor could receive benefits when the deferred annuitant would have reached age 55. We suggest that this inconsistency in the bill be corrected.

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The bill provides free basic life insurance for employees during their working career, but upon retirement they will be required to pay two-thirds of the annual insurance premium until they reach age 65. The Bureau of Labor Statistics survey, as well as other studies we reviewed, showed that 80 percent or more of the employers surveyed provided free life insurance coverage both before and after retirement. The reason why the bill deviates from prevailing private sector practices is not apparent. Since employees covered by this bill would be expected to retire on the average at age 62, which is the norm in the private sector, they would be paying the life insurance premiums for only a few years. Therefore, we suggest that the insurance coverage be provided at no cost to the employee after retirement.

Thrift plan

The bill allows for employees to make tax deferred contributions on a voluntary basis of up to 10 percent of their pay to a thrift savings fund. Employing agencies would match 100 percent of participant contributions up to 5 percent of pay. These contributions could eventually be invested in three funds that would be established and operated by the government --a Government Securities Investment Fund, a Fixed Income Investment Fund, and a Common Stock Index Investment Fund.

We found that few thrift plans in the private sector provide for the employer to match 100 percent of employee contributions. The most common practice in a private sector

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plan was for the employer to match 50 percent of employee contributions up to 6 percent of pay.

The bill also differs from private sector thrift plans by prohibiting employees from withdrawing their funds upon separation before retirement except for transfer to an individual retirement account. We believe that this provision is sound in that it emphasizes the purpose of the plan which is to provide retirement benefits.

The thrift plan's three investment funds seem to provide an appropriate balance between the virtually risk free government securities and fixed income funds on one hand and the higher risk associated with the stock index fund on the other. The inital requirement of all thrift plan funds to be invested in government securities could have a positive impact on the budget by reducing outlays for at least the next five years when this requirement will be phased out.

We suggest that the Committee consider making investment in the government securities fund more attractive by providing the same rate of return on these securities that the pension plan will receive on its investments in government securities. The bill provides for the thrift plan to purchase special issue Treasury notes having 2-year maturities and receiving an interest rate equal to the average market yield of all outstanding 2-year notes as of the end of the preceding month. Other government funds including the civil service retirement fund also invest in special issue government securities but, by

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law, receive an interest rate equal to the average rate on all outstanding securities with maturities over 4 years as of the end of the preceding month. Generally, this rate should be higher than the rate on 2-year securities. The maturities of the special issue securities purchased by the other funds vary depending on the cash flow needs of the funds.

Financing

In our opinion, the provisions for funding pension benefits in the bill are sound and represent a major improvement over the funding requirements in the current civil service retirement system. The bill (1) calls for agencies to pay the full amount of accruing pension costs for their employees, (2) provides for funding of any supplemental liabilities that may arise, and (3) requires the Department of Defense to reimburse the retirement fund for the cost of military service credits granted to employees under the pension plan.

We have long held the view that federal retirement systems should be fully funded to enhance cost recognition and budgetary discipline as well as to promote sounder fiscal and legislative decisionmaking. S. 1527 accomplishes this objective for the new pension plan. However, it does not apply the same funding requirements to the currently underfunded civil service retirement system. We would urge the Committee, either as part of this bill or as a separate action, to address the funding of the current system in a similar manner. Unless this change is made, future benefits for retirees under the current system will

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eventually be paid from funds contributed for the new pension plan.

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In summary, I should reiterate that we see S.1527 as presenting a responsible design of a new federal retirement program. The proposal differs from private sector programs in that the pension plan is less generous at the time of retirement than the private sector norm for average and higher-paid employees, but the thrift plan is more generous than the plans typically found in the private sector. However, depending upon the level of employee contributions to the thrift plan, overall benefits available from the program, in total, can be very competitive with programs in the private sector. We have also suggested some changes that we believe would improve the design of the new program.

This concludes my prepared remarks; I will be pleased to answer any questions you may have.

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